DIRECT TESTIMONY OF

WILLIAM C. KLECKLEY

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2020-125-E

IN RE: APPLICATION OF DOMINION ENERGY SOUTH CAROLINA, INCORPORATED FOR ADJUSTMENT OF RATES AND CHARGES

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is William C. Kleckley. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the State of South Carolina as a Senior Auditor in the Audit Department of the South Carolina Office of Regulatory Staff ("ORS").

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration with majors in Accounting and Finance from the University of South Carolina in December 2017. In June 2018, I began my employment with ORS and since then have participated in cases involving the regulation of electric, gas, water and wastewater utilities. I assumed my current position in August of 2020. I have also passed all sections of the Certified Public Accountant (CPA) exam and am in the process of applying for licensure in South Carolina.

Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA ("PSC" OR "COMMISSION")?

A. Yes, I have previously testified before the Commission.

Q. WHAT IS THE MISSION OF THE OFFICE OF REGULATORY STAFF?

A. ORS represents the public interest as defined by the South Carolina General Assembly as:

> [T]he concerns of the using and consuming public with respect to public utility services, regardless of the class of customer, and preservation of continued investment in and maintenance of utility facilities so as to provide reliable and high-quality utility services.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my direct testimony is to set forth the findings and recommendations resulting from ORS's examination of Dominion Energy South Carolina, Incorporated's ("Company" or "DESC") Application for Increase in Rates and Charges ("Application"). The Application was filed on August 14, 2020. Specifically, I address ORS's finding and recommendations for the following adjustments:

- Adjustment #1 – Annualize Wages, Benefits and Payroll Taxes
- Adjustment #2 – Incentive Compensation Adjustment
- Adjustment #3 – Annualize Health Care
- Adjustment #16 – Voluntary Retirement Program
- Adjustment #17 – Dominion Energy Services Expense
- Adjustment #18 – Synergy Savings
- Adjustment #39 – PSC Support Fees[1]

Q. WAS THE REVIEW PERFORMED BY YOU OR UNDER YOUR SUPERVISION?

Yes. The review to which I testify was performed by me or under my supervision.

Q. PLEASE EXPLAIN ORS'S RECOMMENDED ADJUSTMENTS.

A. Explanations of the ORS accounting and pro forma adjustments are presented on a retail basis for both ORS and the Company.

<u>Adjustment #1 – Annualize Wages, Benefits and Payroll Taxes</u>

[1] ORS's description of Adjustment #39 is consistent with the Company's presentation for simplicity, however, ORS notes that the expenses detailed in this adjustment are better described as a gross receipt's assessment on the utility rather than PSC Support Fees.

The Company proposes to adjust other Operations and Maintenance ("O&M") expenses by ($1,223,000), taxes other than income by ($86,000), income taxes by $326,000, and working capital by ($153,000) for the annualization of wages, benefits and payroll taxes based on a summary of the March 2020 payroll. ORS proposes to adjust other O&M expenses by ($1,802,000), taxes other than income by ($127,000), income taxes by $481,000, and working capital by ($225,000) to annualize wages based on the March 2020 payroll detail provided by the Company. The difference between the Company's and ORS's adjustment amounts is due to a variance that the Company noted in its March 2020 payroll detail which was provided in response to the South Carolina Office of Regulatory Staff's Continuing Request for Production of Books, Records and Other Information ("ORS Request") 5-10. ORS performed sample testing of the March 2020 payroll detail and used the March 2020 payroll detail to calculate its adjustment.

<u>Adjustment #2 – Incentive Compensation</u>

The Company proposes to adjust other O&M expenses by ($1,224,000), taxes other than income by ($106,000), income taxes by $331,000, and working capital by ($153,000) to adjust for the removal of incentive pay accrued above 100% of target level. ORS proposes to adjust other O&M expenses by ($6,740,000), taxes other than income by ($485,000), income taxes by $1,803,000, and working capital by ($843,000) to adjust for the removal of financial performance-based incentive plan components, and the removal of 50% of the salary and benefits for the four (4) highest compensated executives.

Q. PLEASE GIVE AN OVERVIEW OF DOMINION ENERGY'S ANNUAL INCENTIVE PLAN ("AIP").

A. As DESC witness Regina Elbert explains, Dominion Energy provides an annual incentive plan to all employees. Employees can earn points towards their actual award payout based on various goals. The goal categories are 1) consolidated financial goals, 2) business unit financial goals[2], 3) safety, diversity and inclusion, 4) environmental and 5) other operating and stewardship goals. Even after meeting goals, employees can only receive an incentive payout if the AIP is funded. The decision to fund the AIP is made annually by the Dominion Energy board-level Compensation, Governance, and Nominated Committee ("CGN Committee").

Q. HOW DOES THE CGN COMMITTEE SET FUNDING FOR THE AIP?

A. The CGN Committee sets the base funding level for the AIP annually based on a target operating earnings per share ("EPS") which the CGN Committee also establishes. The CGN Committee can adjust the level of funding for the AIP between 0% and 200% based on the operating EPS performance relative to the target operating EPS.[3]

Q. HOW CAN FUNDING AFFECT THE AIP?

A. Funding for the AIP is contingent on Dominion Energy achieving a minimum level of EPS. The target EPS is a threshold that must be met first for there to be <u>any</u> incentive payments to any employee. In other words, no matter how well an employee may perform in their operating and stewardship goals such as safety, if the EPS is below the threshold set by the CGN Committee, then the funding for the plan will be at 0%, and the employee will not receive a bonus. The Company's EPS and decisions made by the CGN are therefore

[2] Exhibit 2 - 2020 AIP in response to ORS Request 2-56 notes that for the 2020 AIP, business unit financial goals will be replaced with a single company wide consolidated financial goal based on EPS.
[3] Exhibit 1 – 2019 AIP in response to ORS Request 2-56; Direct Testimony of Regina J. Elbert, pp. 11-12.

the determining factor as to whether incentive compensation will be paid and to what extent.

Q. WHAT ADJUSTMENT IS ORS PROPOSING REGARDING THE COMPANY'S AIP?

A. ORS is proposing to remove incentive compensation expense classified within other O&M expense and taxes other than income for amounts that are based on consolidated financial goals (EPS) and business unit financial goals. The purpose of this is to remove components of the AIP related to financial performance-based metrics since they are tied directly with increasing the financial performance of the Company rather than individual employee performance.

Q. HAS THIS COMMISSION RULED ON THE RECOVERABILITY OF INCENTIVE COMPENSATION FOR DESC?

A. Yes. The Commission ruled in the 2019 DESC Rate Stabilization Act ("RSA") to disallow portions of the Company's short and long-term incentives attributed to EPS and total shareholder return ("TSR").[4] Both are financial performance measures used to measure earnings. The Commission specifically stated in Order No. 2019-729 on page 3 that, "such payments are not certain, may not be directly attributed to the actions of the Company's employees, and should be made using increased earnings, not through customer rates." The Commission also ruled in that docket to remove fifty percent of the base pay and benefits paid to the Company's four highest compensated executives. The Commission noted on page 3 of Order No. 2019-729 that "This adjustment recognizes that these executives advance the sometimes divergent interest of both shareholders and

[4] Docket No. 2019-6-G, Order No. 2019-729, p. 3.

customers, and that expenses associated with their compensation should therefore be shared."

Q. HOW DOES THE RULING DESCRIBED ABOVE APPLY TO THE INCENTIVE COMPENSATION PLAN EXPENSES INCLUDED FOR RECOVERY IN THIS RATE CASE?

A. The issues covered in the above referenced Commission ruling also apply in this rate case.

1. Incentive plan payment is uncertain as described in the aforementioned ruling. Payment of incentive compensation is often based upon meeting predetermined financial goals such as earnings goals or a target EPS. Therefore, if the goal is not met, then the incentive payment will not be made at the full amount or even at all to employees, but customers will still be charged for the cost associated with incentive compensation tied to financial performance. In this case, if consolidated financial goals and business unit financial goals are not met then some of the incentive payouts will not occur. Moreover, the Company's entire AIP must be funded, which requires Dominion Energy to reach the target EPS set by the CGN Committee.
2. Various factors that can significantly impact earnings may not be directly attributed to the actions of the Company's employees in this case. One such example of this, is how an unusually hot summer can increase the earnings of an electric utility, or similarly, as a cold winter can increase earnings for a gas utility. The Company receives higher revenues than expected through margins from higher utility bills as a result of unusually hot summers or colder than normal winters. The weather is out of the control of utility employees but can trigger financial performance targets being met if there are higher

than usual utility bills due to unusual weather patterns. Customer growth above the growth assumed in rate cases is another factor that may contribute to above-planned revenues and to the achievement of financial performance measures under the incentive plan. Customer growth is something that is typically out of the control of a majority of company employees.

3. Incentive payments based on financial performance measures should be paid from increased earnings that gave rise to the incentive target being met. When financial targets trigger an incentive payment, the company will incur a financial benefit whenever those targets are met. Therefore, the increased earnings which gave rise to meeting the target should be used to compensate employees for incentive payments based on overall Company financial performance and not incentive costs embedded in rates.
4. The customer assumes financial risk of having incentive payments embedded in rates even though the amount collected may not be used to pay for incentive payments if the targets and goals are not reached. The Company and its shareholders do not assume financial risk with incentive costs that are embedded in customer rates.

Q. DOES THE COMPANY OFFER A LONG-TERM INCENTIVE PLAN ("LTIP")?

A. Yes. The Company offers a LTIP to eligible non-executives and to executives. The non-executive LTIP consists of restricted stock grants awarded regardless of performance. For the executive LTIP, half of the LTIP target amount consists of restricted stock grants awarded regardless of performance and half is based on two equally weighted financial performance goals: TSR and return on invested capital ("ROIC").[5]

[5] Direct Testimony of Regina J. Elbert, pp. 20-21.

Q. WHAT ADJUSTMENT IS ORS PROPOSING REGARDING THE COMPANY'S LTIP?

A. ORS proposes to remove other O&M expense and taxes other than income for amounts based on the financial performance metrics TSR and ROIC. Consistent with the recommendation for the AIP, ORS proposes to remove these amounts directly tied to the financial performance of the Company rather than the provision of safe and reliable electric service to customers at the lowest possible cost. The prior Commission rulings and four reasons discussed above for not charging customers for incentive payments based on financial performance also apply to the Company's LTIP.

Q. IS ORS PROPOSING ANY OTHER ADJUSTMENTS REGARDING COMPENSATION AND BENEFITS?

A. Yes. ORS proposes to remove 50% of the amounts related to base salary and benefits for the four highest compensated executives.

Q. WHAT IS THE BASIS FOR REMOVING AMOUNTS RELATED TO THE FOUR HIGHEST PAID EXECUTIVES?

A. Executives and officers hold a fiduciary duty to the company's shareholders. This can create a tension between maximizing returns for shareholders and minimizing the charges collected from customers for affordable, safe and reliable service. Dominion's executive level positions have incentive goals heavily weighted towards financial performance goals in contrast to operating and stewardship goals.

Q. PLEASE ADDRESS DESC WITNESS ELBERT'S ASSERTIONS THAT INCENTIVE PLANS SHOULD BE INCLUDED IN CUSTOMERS RATES AS PART

OF THE TOTAL COMPENSATION PACKAGE NEEDED TO BE COMPETITIVE WITH OTHER UTILITIES AND TO RETAIN QUALIFIED EMPLOYEES.

A. DESC's argument for including in rates incentive payments based on Company financial performance is that the plans are consistent with other utilities in that incentive plans are needed as part of a total compensation package needed to attract and retain qualified employees.[6] The problem with this line of thinking is that regulators' duties are not to determine what or how a utility should compensate its employees, but to ensure that charges to customers are reasonable. Therefore, the regulator's role is to determine what utility customers should pay for. Some commissions do not permit utilities to charge customers for incentive plans and payments designed to drive earnings.[7] This Commission and other commissions have determined that there should be a sharing of costs between the customer and shareholders. Given this, the Company is not a disadvantage relative to other utilities because similar approaches are taken by other commissions in disallowing incentive payments based on financial performance measures designed to increase earnings.

An additional issue with the argument that customers should pay for financial-performance based incentive costs that are part of a total compensation package is that when a utility meets its financial performance goals there should be a recognized financial benefit to the company. The increased earnings that help achieve these financial goals should provide the funds necessary to pay for the incentives tied to meeting those same financial goals. Therefore, the Company is not at a disadvantage if incentive payments are

[6] Direct Testimony of Regina J. Elbert, pp. 3-8.
[7] See "Incentive Compensation Survey of the 24 Western States", Appendix MG-3 to the testimony of Mark E. Garrett, dated August 20, 2019 in Cause No. 45235 before the Indiana Utility Regulatory Commission, available at: https://www.in.gov/oucc/files/45235MarkGarrett.pdf.

excluded from rates, because the funding for these payments should come from the additional earnings that the incentive plans helped achieve.

Q. PLEASE ADDRESS DESC WITNESS ELBERT'S ASSERTIONS THAT CUSTOMERS BENEFIT FROM PAYING FOR EARNINGS, RETURNS AND OTHER FINANCIAL GOALS INCLUDED IN INCENTIVE PLANS.

A. Many of the reasons why DESC's assertion is inaccurate are previously discussed in my testimony. There are several other factors that make the "customer benefits" speculative. First, the payment of incentives is uncertain. If financial performance goals are not met by the Company, then the incentives tied to those measures will not be paid out to DESC employees. This is particularly true for DESC, considering that funding of the AIP is contingent on an EPS threshold being met. Consequently, there is no guarantee that any incentive payment will be made now or in the future.

Another concern ORS has with the Company's methodology of using financial performance-based goals for incentive pay is that the Company incentive compensation metrics exclude the effects of extraordinary and non-recurring gains or losses. This would indicate that all penalties and fines levied against a utility are excluded from the calculation of the financial performance goals since they are typically non-recurring in nature. If the company is fined for something such as environmental violations, the company may not have been operating in the best interests of customers regarding the provision of safe and reliable service. Therefore, the exclusion of certain extraordinary or nonrecurring items from the calculation of EPS does not necessarily give a true representation of the operating effectiveness of a company.

Q. IN SUMMARY, WHAT IS ORS'S POSITION ON INCENTIVES AND EXECUTIVE COMPENSATION?

A. ORS proposes to remove amounts from incentive payments associated with financial performance-based goals for the Company's AIP and LTIP, and 50% of the base pay and benefits of the top four highest paid executives. Among the reasons for disallowing the costs are: it comports to prior Commission Order, the incentive plan must first be funded through meeting an EPS target, payment of incentives are uncertain because of the financial goals that must be met, the increased earnings that give rise to meeting financial goals should be adequate to pay for incentive payments, and certain events that can affect earnings are outside the control of most employees such as unusual weather and unplanned customer growth.

Q. PROVIDE A SUMMARY OF THE AMOUNTS ORS PROPOSES TO REMOVE FOR THE AIP, LTIP AND FOUR HIGHEST PAID EXECUTIVES IN ADJUSTMENT #2.

A. The Table below depicts the amounts ORS proposes to remove associated with executive and non-executive AIP, executive LTIP and the top four (4) highest paid executives.

	Executive	Non-Executive	Total
AIP	$1,038,201	$4,012,991	$5,051,192
LTIP	1,650,283		1,650,283
Top 4 Executive Pay/Benefits	204,723		204,723
Total	$2,893,207	$4,012,991	**$6,906,198**

Q. PLEASE CONTINUE THE EXPLANATION OF ORS'S RECOMMENDED ADJUSTMENTS.

A. Adjustment #3 – Annualize Health Care

The Company proposes to adjust other O&M expenses by $3,054,000, income taxes by ($762,000), and working capital by $382,000 to annualize employee health care expenses using quarter 4 ("Q4") (October – December) of 2019. ORS proposes to adjust other O&M expense by ($543,000), income taxes by $135,000, and working capital by ($68,000) to annualize health care expenses using the average of Q4 2019 and quarter 1 ("Q1") (January – March) of 2020. The difference in the Company's and ORS's adjustment amounts is due to the different periods used to annualize health care expenses.

ORS's methodology better estimates health care expenses going forward. The levels of employee health care expenses vary throughout the year as indicated by the Company's response to ORS Request 6-7 which asserts that claims and associated expenses are traditionally lower in the first quarter as compared to other quarters due to deductibles that must be satisfied. Using this same logic, expenses in the fourth quarter could be higher as compared to other quarters since more deductibles would have been met. To normalize the fluctuations in health care costs, ORS took an average of the amounts from the Q4 2019 period and the Q1 2020 period to calculate the adjustment.

Adjustment #16 – Voluntary Retirement Program

The Company proposes to adjust other O&M expense by ($3,303,000), taxes other than income by ($203,000), income taxes by $875,000, and working capital by ($413,000) to capture additional savings of the voluntary retirement program beyond what was accounted for in the annualized test year as calculated in Adjustment #1. The Company provided an update to this adjustment in response to ORS Request 8-6. Through that response the Company proposes to adjust other O&M expense by ($2,155,000), taxes other than income by ($132,000), income taxes by $571,000, and working capital by ($269,000). In the updated adjustment, the Company identified the employees participating in the voluntary retirement program using the March 2020 payroll detail that was used by ORS to annualize wages, benefits and taxes in Adjustment #1. The Company then removed those employees associated salaries, benefits and taxes on an annualized basis to calculate Adjustment #16. ORS verified and accepts the Company's updated adjustment as provided in its updated response to ORS Request 8-6.

<u>Adjustment #17 – Dominion Energy Services ("DES") Expense</u>

The Company proposes to adjust other O&M expense by $8,944,000, income taxes by ($2,231,000), and working capital by $1,118,000 to annualize April 2020 expenses that originated at the DES level and were allocated to DESC. The Company provided an update to this adjustment in response to ORS Request 8-6. Through that response the Company proposes to adjust other O&M expense by $8,092,000, income taxes by ($2,019,000), and working capital by $1,012,000 to include the removal of costs that should have not been included in the adjustment. ORS proposes to adjust other O&M expense by $8,080,000, income taxes by ($2,016,000), and working capital by $1,010,000. The difference between the Company's updated adjustment and ORS's adjustment amounts is due to additional items removed by ORS.

The Company identified COVID-19 advertising and consulting related costs that should have been removed as part of its update in ORS Request 8-6. ORS identified $1,061 in COVID-19 related costs in addition to the ones identified by the Company as a result of ORS's sample testing of the Company's response to ORS Request 6-18. The additional costs removed by ORS are non-recurring charges and not representative of the Company's expected operating experience going forward. Therefore, those costs should not be included when annualizing DES April 2020 expenses allocated to DESC.

Adjustment #18 – Synergy Savings

The Company proposes to adjust other O&M expense by ($773,000), income taxes by $193,000, and working capital by ($97,000) to recognize non-labor cost savings that are not reflected in the test period. The Company provided an update to this adjustment in response to ORS Request 8-6. Through that response the Company proposes to adjust other O&M expense by ($823,000), income taxes by $205,000, and working capital by ($103,000). The non-labor cost savings consist of aviation, information technology contracts and subscriptions expenses. The difference in the Company's adjustment amounts is due to the update which was made to reflect the actual allocated aviation expenses to DESC in the test year. ORS verified and accepts the Company's updated adjustment as provided in response to ORS Request 8-6.

Adjustment #39 – PSC Support Fees

The Company proposes to adjust taxes other than income by ($1,745,000) and income taxes by $435,000 for changes in gross receipt's fees occurring after the test period. The Company provided an update to this adjustment in response to ORS request 6-33(28) and 8-6. Through those responses the Company does not propose to adjust taxes other than income and income taxes for gross receipt's fees. The utility assessment bill used by the Company for its original adjustment calculation was based on the 2019 year in which there was a Commission ordered reduction to revenue to establish a regulatory liability for refunds to customers.[8] Given this was a one-time reduction to revenue, the level of gross

[8] Docket No. 2017-305-E, Order No. 2018-804.

receipt's fees on that utility assessment bill are not reflective of a normal year. Therefore, no adjustment is necessary to normalize gross receipt's fees. ORS verified and accepts the Company's updated adjustment as provided in response to ORS Request 6-33(28) and 8-6.

Q. WILL YOU UPDATE YOUR DIRECT TESTIMONY BASED ON INFORMATION THAT BECOMES AVAILABLE?

A. Yes. ORS fully reserves the right to revise its recommendations via supplemental testimony should new information become available not previously provided by the Company.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.